Request for Information: Post-implementation Review – IFRS 13 Fair Value Measurement

Dear Hans,

Mazars welcomes the opportunity to comment on the International Accounting Standards Board’s Request for Information (hereafter RFI) Post-implementation Review – IFRS 13 Fair Value Measurement, issued in May 2017.

We welcome the IASB looking into the implementation of major standards and especially of this particular standard on how to measure fair value and what disclosures to make.

Whilst we consider that IFRS 13 has generally worked well in that the provision of a single definition of fair value and of a framework on how to measure fair value has enhanced consistency and comparability, there are a number of areas where stakeholders have faced challenges, amongst which:

- The issue on prioritising Level 1 inputs versus the unit of account, for which we encourage the Board to address the issue with the aim to make the resulting information relevant and a faithful representation of the situation/transaction;
- The requirement to assess the highest and best use of non-financial assets taking any market participant views and not reflecting the intent or the business model for which/within which the asset is used by the entity. Here too we encourage the Board to address this issue with the aim to make the resulting information relevant and a faithful representation of the situation reflecting the use of the related asset within the context of the business model within which that asset is used; and
- The measurement at fair value of growing produce on bearer plants, for which we encourage to Board to analyse the issue and determine the best course of action to take based on the relevant due process criteria: adapt the measurement requirements under IAS 41 or provide educational guidance.
Our detailed comments to the questions raised in the Discussion Paper are set out in the Appendix.

Please do not hesitate to contact us should you want to discuss any aspect of our comment letter.

Yours sincerely,

Michel Barbet-Massin  
*Head of Financial Reporting Technical Support*
Appendix

**Question 1A – Your background**

Please tell us:

(a) your principal role in relation to fair value measurement. For example, are you a preparer of financial statements, an auditor, a valuation specialist, a user of financial statements, a regulator, a standard-setter, an academic, or a professional accounting body? If you are a user of financial statements, what kind of user are you (for example, buy-side analyst, sell-side analyst, credit rating analyst, creditor/lender, asset or portfolio manager)?

(b) your principal jurisdiction and industry. If you are a user of financial statements, which geographical regions and industries do you follow or invest in?

Mazars is an international, integrated and independent organisation, specialising in audit, accountancy, tax, legal and advisory services, including valuation services. Our firm primarily audits financial information prepared in accordance with IFRSs.

Mazars can rely on the skills of 18,000 professionals in the 79 countries which make up its integrated partnership worldwide.

We assist clients of all sizes, from SMEs to mid-caps and global players as well as start-ups and public organisations, at every stage of their development.

**Question 1B – Your experience**

How extensive is your experience in relation to the measurement of the following items at fair value (including the measurement of their recoverable amount on the basis of fair value less costs of disposal)?

Our experience in relation to the measurement of items under IFRS at fair value may be summarised as follows:

<table>
<thead>
<tr>
<th>Type of item</th>
<th>The extent of your experience with fair value measurements</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Little</td>
</tr>
<tr>
<td>Property, plant and equipment</td>
<td></td>
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<tr>
<td>Intangible assets including goodwill</td>
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<tr>
<td>Investment properties</td>
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<tr>
<td>Biological assets</td>
<td></td>
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<tr>
<td>Investments in subsidiaries, joint ventures or associates</td>
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<tr>
<td>Financial instruments</td>
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<tr>
<td>Other (please specify which)</td>
<td></td>
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</table>
Question 2—Fair value measurement disclosures

(a) How useful do you find the information provided about Level 3 fair value measurements? Please comment on what specific information is useful, and why.

(b) In your experience of Level 3 fair value measurements:
   (i) how do aggregation and generic disclosure affect the usefulness of the resulting information? Please provide examples to illustrate your response.
   (ii) are you aware of any other factors (either within or outside IFRS requirements) affecting the usefulness of the information? Please provide examples to illustrate your response.
   (iii) do you have suggestions on how to prevent such factors from reducing the usefulness of the information provided?

(c) Which Level 3 fair value measurement disclosures are the most costly to prepare? Please explain.

(d) Is there information about fair value measurements that you think would be useful and that IFRS 13 does not require entities to disclose? If yes, please explain what that information is and why you think it would be useful. Please provide any examples of disclosure of such information.

The information provided about Level 3 fair-value measurements appears to be generally useful. However, we consider that it is sometimes difficult to exercise judgment in relation to:

- The materiality of individual inputs or disclosures, especially in the context of aggregation;
- The distinction between Level 2 and Level 3 measurements, the consequences of which results in significantly more disclosures regarding Level 3 measurements. We note that securities regulators tend to consider that, more often than not, the measurement, when it is not a Level 1 measurement, falls under the Level 3 category.

We consider that IFRS 13 should remain principles-based as valuation techniques constantly change. Therefore, we would encourage the Board to consider reviewing the disclosures section of IFRS 13 in the light of the principles it will develop within the context of its Disclosure Initiative (see also our comment letter on the Principles of Disclosure Discussion Paper, dated 4th October 2017).
**Question 3—Prioritising Level 1 inputs or the unit of account**

(a) Please share your experience to help us assess:

(i) how common it is for quoted investments in subsidiaries, joint ventures and associates, and quoted cash-generating units to be measured at fair value (please support your comments with examples).

(ii) whether there are material differences between fair value amounts measured on the basis of \( P \times Q \) alone (when \( P \) is the quoted price for an individual instrument and \( Q \) is the quantity of financial instruments held) and fair value amounts measured using other valuation techniques. Please provide any examples, including quantitative information about the differences and reasons for the differences.

(iii) if there are material differences between different measurements, which techniques are used in practice and why.

Please note whether your experience is specific to a jurisdiction, a region or a type of investment.

(b) The Board has undertaken work in this area in the past (see Appendix 3). Is there anything else relating to this area that you think the Board should consider?

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**Fair value measurement of quoted investments in subsidiaries, joint ventures, associates and quoted cash-generating units**

In the context of quoted investments in subsidiaries, joint ventures, associates and quoted cash-generating units, we consider that the unit of account is the investment as a whole and that the measurement should take into account the characteristics of that unit of account.

To illustrate this, if an entity owns 49% of a quoted entity and wishes to acquire 51% to control that quoted entity, we expect that the price to be paid to acquire the 2% needed would exceed the market value of the related shares as market participants would understand the change in status of the acquiring company.

Similarly, when an entity wishes to dispose of a significant number of shares in a quoted-entity, the fact that the quantity is above the usual number of exchanges on those shares implies that the market needs to absorb the number of shares and will require a liquidity discount to that effect. On the contrary, in other circumstances, the size of the stake may induce the payment of a premium by third parties.

This, in our view, demonstrates the impact of the investor’s control or degree of influence on the fair value of a significant instrument.

This can further be illustrated with the following real-life example.

In June 201X, Entity A distributed to its owners 75% of the shares of its subsidiary, Entity B, which became listed on that day. This distribution led to the loss of control over Entity B, but Entity A retained significant influence due to its remaining 25% stake in its former subsidiary.
Accounting for this loss of control required to measure the remaining interests in Entity B held by Entity A at fair value, and to apply IAS 28 to the initial recognition of an investment in an associate on the basis of that fair value. Any difference between the fair value of the remaining 25% interest in Entity B and 25% of the book value of the consolidated net assets of Entity B just before the distribution was recognised through P&L.

The distribution transaction was prepared on the basis of a “reference value” measured by investments bankers. That value was considered by the management of Entity A to be the fair value of Entity B at distribution date, and any financial communication before the distribution was made on the basis of that value.

Whilst the “reference value” of the remaining 25% amounted to 80 MEUR, the fair value of the investment on the distribution date, measured on the basis of a PxQ formula using the first quoted price of Entity B’s shares, led to a global value of 101 MEUR.

The management of Entity A considered that measurement to be irrelevant, but the PxQ formula was enforced by the regulator. The remeasurement profit was therefore recognised on that basis, and was 21 MEUR higher than expected.

In the days immediately following the distribution, the share price of Entity B significantly decreased, and this led Entity A to carry out an impairment test for the interim financial statements as at 30 June 201X. The fair value less costs to sell of the investment was measured at 83 MEUR on 30 June 201X, and Entity A accounted for an impairment loss of 18 MEUR.

Using a PxQ formula for measuring the fair value at distribution date led Entity A to recognise within a 2-week period of time an extra remeasurement profit of 21 MEUR, and an impairment loss of 18 MEUR. The resulting financial information appeared so irrelevant that Entity A explained in its interim financial statements that this accounting outcome was the result of a strict application of IFRSs.

**Fair value measurement of other instruments**

In our view, the PxQ issue is also an issue for other types of instruments such as financial instruments. To illustrate this, we provide the following example of the CVA calculation on derivatives in the context of a Master Agreement

Entity A enters into a number of transactions on derivatives with Entity B under a Master Agreement.

If Entity B were to default, the positive (equalling 100) and negative (equalling 80) positions Entity A has against Entity B will be netted and the risk will be assessed based on this net position (equalling 20). The CVA therefore is calculated on the basis of the net position.

However, the CVA needs to then be reallocated to each derivative constituting the position. The only way to do that is to define a rule of the allocation. Whatever rule is applied, the result will not reflect economic reality as calculating the CVA on a net position cannot reflect the specific characteristics of each of the derivatives included in the position, amongst which the fact that the CVA is supposed to reflect the value of the default risk on each derivative in the future.
Conclusion

Even though the use of PxQ may result in more verifiable information, it could lead in some circumstances, amongst which those described above, to counterintuitive outcomes. Measuring fair value without adjustments could result in day-1 gains, or more commonly losses, which are not representative of the investment performance since the price that market participants are willing to pay often include either control premiums or liquidity discounts or reflect the use of statistical analyses or other factors which are specific to the facts and circumstances of the situation or the transaction.

Based on the above, and in view of the fact the differences between measuring fair value based on PxQ alone and fair value based on other measurement techniques can be material, we consider that the fair value measurement needs to be able to take into account the specific circumstances of the unit of account considered and would encourage the Board to look into this specific and contentious issue.

We would not consider that imposing a PxQ measurement in the financial statements without taking into account the specific circumstances of the unit of account, whilst requiring or relying on the provision of disclosures to explain the differences would be satisfactory. On the contrary, we would consider that this would undermine the credibility of IFRS.

**Question 4—Application of the concept of highest and best use for non-financial assets**

*Please share your experience to help us assess:*

(a) whether the assessment of an asset’s highest and best use is challenging, and why. Please provide examples to illustrate your response.

(b) whether the current uses of many assets are different from their highest and best use, and in which specific circumstances the two uses vary.

(c) whether, when applying highest and best use to a group of assets and using the residual valuation method, the resulting measurement of individual assets in the group may be counter-intuitive. If so, please explain how this happens, and in which circumstances.

(d) whether there is diversity in practice relating to the application of the concept of highest and best use, and when and why this arises.

*Please note whether your experience is specific to a jurisdiction, a region or a type of asset.*

The highest and best use concept applies primarily to real estate, intangible assets such as brands and biological assets, in both the context of transactions or situations related to these individual assets or in the context of business combinations.

We note that the assessment of a non-financial asset’s highest and best use is challenging due to the fact that this needs to be made taking into account market participants’ assessment of the highest and best use with no regard of the business model carried out by the entity within which the related asset is being used. In a number of cases, the conditions around the rebuttal of the presumption under IFRS 13.29, according to which the current use of the asset by the entity is its highest and best use, are such that the presumption is not valid. Therefore, the challenges in assessing the use of the asset that would maximize the value from the asset come from having to resort to hypothetical transactions in the absence of actual transactions and therefore having to perform a number of hypothetical assumptions which have no economic foundation. This raises issues in terms not only of the reliability of the information but also of its verifiability.
In addition to these challenges, we consider therefore that the premise this concept is based on, as it does not take into account the business model within which the related asset is used, leads to information that is not relevant to the users as it does not take into account the induced costs that a different scenario for its use would entail: for example, if the optimal use in terms of value for a factory is to tear it down and build a shopping mall, the entity would have to entail redundancy costs, relocation costs, potentially also reimburse subsidies received…. As the fair value calculated does not take these into account, the information provided would only be partial. In addition, such a hypothesis is in conflict with the going concern assumption based on which financial statements are drawn up as defined in the Conceptual Framework.

We therefore encourage the Board to reinvestigate this issue with the objective to providing relevant and faithful information to users of financial statements.
Question 5—Applying judgements required for fair value measurements

Please share your experience to help us assess the challenges in applying judgements when measuring fair value:

(a) is it challenging to assess whether a market for an asset or a liability is active? Why, or why not?
(b) is it challenging to assess whether an input is unobservable and significant to the entire measurement? Why, or why not?

Please provide specific examples to illustrate your response and note whether your experience is specific to a jurisdiction or a region or a type of asset or liability.

We note that there have been some cases where different views have arisen as regards whether a market for an asset or a liability is active. Whilst, it may still be challenging in some cases, we also note that their occurrence have diminished in the recent past.

Question 6A—Education on measuring biological assets at fair value

Please describe your experience of measuring the fair value of biological assets:

(a) are any aspects of the measurement challenging? Why, or why not? Please provide examples to illustrate your response.
(b) what, if any, additional help would be useful in applying IFRS 13? In which areas?

Rebutting the presumption that fair value can be measured reliably

We are aware of the following concerns in some jurisdictions about rebutting the presumption that fair value can be measured reliably on the grounds of difficulty and lack of reliability of a fair value measure:

- Different points in the production cycle: when should the fair value be estimated?
  - o from the pollination date?
  - o or when the produce is first visible?
  - o or should the total produce each bearer plant can produce over the production cycle be taken into account?
- Various factors, such as climate, rainfall, haze, terrain, husbandry, production yield, fluctuations of commodity price and others, including fertilizers, have impact on the value of growing produce.
  - o Some are within the control of the entity and some are beyond its control thus making the predictability a difficult task.
  - o It is also argued that the cost can outweigh the benefit due to this subjectivity, as well as the consistency (even within the industry) of those estimates.

In an outreach carried out by the IFRS IC, we have performed a desktop review and found that some entities within the same type of business have rebutted the presumption, others have not but do not use the information internally, whilst others having not rebutted the presumption provide such wide ranges in the assumptions of a Level 3 measurement that this raises a question in terms of reliability/uncertainties.
In terms of industries where this presumption is an issue, we know this is the case for:
- Palm fruit for the reasons indicated above
- Other fruit trees in general as:
  - The fruit only have value at harvesting
  - Until harvesting, the harvest may be lost and large portions often are, so the balance sheet might be inflated
- For strawberry plants that are parent plants used to produce other plants, their "fruit" are also bearer plants
- The latex/rubber industry as well as maple syrup production as the produce is only visible once tapped from the tree.

**Measurement other than fair value (when above presumption rebutted)**
Having rebutted the presumption, the issue then moves on to the measurement. We have noted that some appear to not be valuing growing produce until harvest point, whilst others use a prorata temporis calculation based on the estimated yield and market value.

On the above issues, we would encourage the Board to investigate them further and upon such investigation to decide whether any reconsideration of IAS 41 is warranted or whether education guidance would suffice to address them.

**Question 6B—Education on measuring unquoted equity instruments at fair value**
*Please describe your experience of measuring the fair value of unquoted equity instruments:*

(a) in 2012, the IFRS Foundation Education Initiative published Unquoted equity instruments within the scope of IFRS 9 Financial Instruments. Have you used this education material? If so, how did this material help you to measure the fair value of unquoted equity instruments?

(b) do you have questions not covered in Unquoted equity instruments within the scope of IFRS 9 Financial Instruments? Do you think that additional help would be useful in applying the requirements? Why, or why not? Please provide examples to illustrate your response.

We do not have any comment on this question.
Question 7—Effects and convergence

(a) Please share your experience of the overall effect of IFRS 13:

(i) what effect did IFRS 13 have on users' ability to assess future cash flows? If you are a user of financial statements, please provide us with examples of how you use information provided by entities about their fair value measurements and any adjustments you make to the measurements.

(ii) what effect did IFRS 13 have on comparability of fair value measurements between different reporting periods for an individual entity and between different entities in the same reporting period?

(iii) what effect did IFRS 13 have on compliance costs; specifically, has the application of any area of IFRS 13 caused considerable costs to stakeholders and why?

(b) Please comment on how you are affected by the fact that the requirements for fair value measurement in IFRS 13 are converged with US GAAP; and please comment on how important it is to maintain that convergence.

Whilst there are differences between US GAAP and IFRS in terms of when fair value is required, we consider it is important that the convergence between the two sets of standards is maintained.

Question 8—Other matters

Should the Board be aware of any other matters as it performs the PIR of IFRS 13? If so, please explain why and provide examples to illustrate your response.

We are not aware of any other matters that the Board should consider in its PIR of IFRS 13.